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# Can California's Resale Milk Pricing Law Survive the Supermarket?

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## Can California's Resale Milk Pricing Law Survive The Supermarket?

*It would be an understatement to say that maintenance of an adequate and continuous milk supply at reasonable prices is in the interest of almost all California consumers. Until recently, price stability in the distribution of fluid milk was achieved by the Director of the Department of Food and Agriculture under guidelines prescribed by the Milk Stabilization Act. However, a recent Los Angeles County Superior Court decision has posed a challenge to the effectiveness of the Act by approving a joint venture arrangement which, in effect, allows member stores to reduce their wholesale fluid milk price below the state-established minimum. This in turn has opened the door to other arrangements which can circumvent the Act's minimum price standards. This comment is an analysis of the growth of integration in the milk industry, the joint venture arrangement, and the effect of new developments in milk distribution which threaten the continued existence of the minimum wholesale and minimum retail pricing provisions of the Milk Stabilization Act.*

For the past thirty-seven years the California Milk Stabilization Act has furnished the basis for public regulation of minimum prices in the turbulent and highly competitive fluid milk industry.<sup>1</sup> Reflecting the constantly changing economics of the industry, the Act, together with the complementary Dairy Products Unfair Practices Act,<sup>2</sup> has, somewhat uniquely, been the subject of legislative attention at every regular session of the California Legislature since 1937.<sup>3</sup> Although supported by this remarkable record of statutory endurance, the Act now faces its greatest test of survival—a test produced by the continuing growth and development of supermarket distribution of food, including milk

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1. CAL. FOOD & AGRIC. CODE §61801 *et seq.*, as amended, CAL. STATS. 1937, c. 3, at 42, c. 57, at 151, c. 413, at 1372, c. 710, at 1989. For excellent summaries of the chaotic conditions of instability in the California dairy industry in the 1930's prior to the enactment of the Milk Stabilization Act, see J. TINLEY, PUBLIC REGULATION OF MILK MARKETING IN CALIFORNIA (1938); Kuhrt, *The Story of California's Milk Stabilization Laws, From Chaos to Stability in the California Milk Industry*, 54 CAL. DEP'T OF AGRIC. BULL. 176 (1965); see also text accompanying notes 18-22 *infra*.

2. CAL. FOOD & AGRIC. CODE §61301 *et seq.*

3. No attempt is made here to detail the scores of amendments attempted and accomplished through all the legislative sessions since 1937.

and milk products,<sup>4</sup> coupled with a recent court decision which found an imaginative new distribution scheme to be legal under the Act.<sup>5</sup>

Since its inception, the effectiveness of the Milk Stabilization Act and the authority of the Director of the California Department of Food and Agriculture to establish minimum wholesale and minimum retail prices under the Act have been continually challenged by various marketing arrangements which have developed within the milk industry as the demand for supermarket food distribution has grown. These arrangements have principally involved a combination between milk processors and retail outlets designed to afford those involved a greater profit margin over that available where fluid milk is sold by conventional distributors and stores at state-established minimum wholesale and minimum retail prices.

One such arrangement, single-ownership integration, as exemplified by Safeway Stores and Ralphs Grocery Company,<sup>6</sup> has been in existence since the enactment of the Milk Stabilization Act<sup>7</sup> and is recognized in the Act by a specific exemption from minimum wholesale price regulation.<sup>8</sup> Under this type of integration, the retail outlet owns its own processing plant. Due to the exemption from minimum wholesale pricing and the substantial cost savings which such an operation realizes, the store is able to receive its fluid milk at a cost below the state-established minimum wholesale price which normally governs sales between processors and stores.<sup>9</sup> Few stores, however, are large enough to own and operate their own milk processing plant; thus widespread usage of single-ownership integration has been limited.<sup>10</sup>

In contrast to single-ownership integration, another type of integration, which is based on multi-store ownership of a processing plant and is exemplified by Jerseymaid and Golden Creme,<sup>11</sup> was also developed early in the history of the Act. Although it appears that multi-store integration avoided application of certain pricing provisions of the Act, it involved substantial investment risks and exhibited little

4. See text accompanying notes 56-64 *infra*.

5. *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973).

6. Record, vol. 1, at 17, *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973) [hereinafter cited as Record].

7. CAL. FOOD & AGRIC. CODE §61812, enacted, CAL. STATS. 1937, c. 413, at 1372; see also *Public Hearings Relative to Minimum Wholesale and Minimum Retail Price Orders for Fluid Milk Currently in Effect in All Milk Marketing Areas of California Before the California Dep't of Food and Agriculture, Bureau of Milk Stabilization*, Aug. 29-31, 1973, at 70 [hereinafter cited as *August Minimum Resale Price Hearings*].

8. CAL. FOOD & AGRIC. CODE §61812.

9. *Id.*

10. See Exhibit 29, *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973) [hereinafter cited as Exhibit] (introduced into evidence on July 17, 1973).

11. Record, vol. 11, at 1235.

in the way of new development after the mid-1950's when the Act was amended to provide for quantity discounts in wholesale sales of fluid milk.<sup>12</sup>

Because of the self-limiting aspects of single-ownership and multi-store integration and because of various legislative amendments to the Act, a measure of stability has been maintained in the industry.<sup>13</sup> Recently, however, the most significant threat to the continued effectiveness of the Act has arisen by way of a joint venture arrangement. Under this scheme, stores whose volume requirement qualifies them for joint venture participation purchase milk from a processing plant which is owned jointly by themselves and the processor. Ownership dividends are later paid by the jointly owned processor to the stores based upon the measure of their purchases. This effectively reduces the prices paid by the stores for fluid milk below the state-established minimums.<sup>14</sup> Unlike those types of integration in which stores risk a substantial investment on their processing expertise and label, the joint venture requires a much smaller capital investment and sales volume on the part of the participating stores with very little risk attending such participation since an established processor furnishes both the expertise and the publicly accepted label to make the venture a success.<sup>15</sup> Despite efforts by the Director to enjoin this operation, the legality of the joint venture has now been judicially confirmed.<sup>16</sup>

This recent development raises the question of whether or not the Act, in its present or an amended form, can be effectively implemented to achieve its primary purpose—the maintenance of stability in the dairy industry through public regulation of minimum wholesale and minimum retail prices for fluid milk. Due to the legality of the joint venture arrangement, as well as the possibility of other ingenious marketing schemes coming into existence,<sup>17</sup> the Director is now faced with the problem of whether he can establish in the public interest a minimum wholesale and a minimum retail price which will insure an adequate supply of fluid milk to all of the consuming public through both integrated and nonintegrated retail outlets, without creating unreasonable profits for those processors and retail stores tied together by some type of integration arrangement. Depending on how well the Direc-

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12. *Id.* at 1251; CAL. FOOD & AGRIC. CODE §62482 (quantity discount provision).

13. See text accompanying notes 74-81 *infra*; Record, vol. 11, at 1250-51.

14. Presentation by the Director, California Department of Food and Agriculture, at 2 [hereinafter cited as *California Milk Marketing Presentation*], delivered at, *Hearings on California Milk Marketing Program Before the California Senate and Assembly Interim Committees on Agriculture*, Nov. 8, 1973, San Diego, Calif.

15. Record, vol. 11, at 1236-37; *California Milk Marketing Presentation* at 2.

16. *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973).

17. See text accompanying notes 124-28 *infra*.

tor can solve this problem, it appears that both the dairy industry and consumers must consider whether there is in fact a continuing need for such regulation to prevent the return of those economic conditions which first necessitated price control and, if so, what changes should be made to insure the Act's effective application. This comment will examine and seek resolutions to these problems which are important to both the dairy industry and the general public.

## PUBLIC REGULATION OF RE SALE MILK PRICING IN CALIFORNIA

### A. Origins

Recognizing milk to be a vital human food and an essential item of diet, California joined other states in the 1930's in enacting legislation<sup>18</sup> providing for minimum price regulation of fluid milk in order to curb chaotic economic conditions in the industry<sup>19</sup> and to assure the public of an adequate supply of milk.<sup>20</sup> The problems of the industry stemmed partly from the general business depression, partly from the perishable character and the dietary importance of milk, and partly from the shift from home delivery to store distribution as California became increasingly urbanized.<sup>21</sup> Resulting price wars threatened the existence of many producers and distributors in the dairy industry, in turn jeopardizing the overall supply of milk to the consuming public.<sup>22</sup>

In 1937, the California Legislature responded to an industry beset by unfair trade practices and characteristics which inherently caused "disorderly marketing and price instability,"<sup>23</sup> by adding the Milk Stabilization Act to what is now the California Food and Agricultural Code.<sup>24</sup> Under the Act, the Director of the California Department of Food and Agriculture is required to establish minimum prices for fluid milk sold by producers to distributors, by distributors to other distributors and to retail stores, and by distributors and retail stores to consumers.<sup>25</sup> As delineated in its provisions,<sup>26</sup> the purposes of the Act include safeguarding the public interest by insuring an adequate

18. CAL. FOOD & AGRIC. CODE §61801 *et seq.* (formerly, CAL. AGRIC. CODE §736.10 *et seq.*); Kuhrt, *supra* note 1.

19. J. TINLEY, *supra* note 1, at 29-31; Kuhrt, *supra* note 1, at 177-79.

20. CAL. FOOD & AGRIC. CODE §§61872, 61877.

21. J. TINLEY, *supra* note 1, at 2-5, 26-27; Kuhrt, *supra* note 1, at 176-77.

22. J. TINLEY, *supra* note 1, at 9; Kuhrt, *supra* note 1, at 178-79.

23. Testimony of L. A. Maes, Executive Director of Dairy Institute of California, *August Minimum Resale Price Hearings* at 67.

24. CAL. FOOD & AGRIC. CODE §61801 *et seq.* (formerly, CAL. AGRIC. CODE § 736.10 *et seq.*).

25. CAL. FOOD & AGRIC. CODE §§61811, 61812, 61819, 62212, 62471, 62472, 62474, 62486.

26. CAL. FOOD & AGRIC. CODE §§61871-61878.

and continuous supply of the highest quality product at fair and reasonable prices, and achieving a stable industry through prevention of monopoly and preservation of "orderly marketing" and "reasonable prosperity."<sup>27</sup> This latter objective is realized through the establishment of minimum wholesale prices which provide reimbursement for reasonable handling costs and return on investment to milk processors who supply their products in varying quantities to all kinds of purchasers,<sup>28</sup> and the similar establishment of minimum retail prices to apply to all retail stores, regardless of size.<sup>29</sup> The purposes of the Act are reiterated in the following judicial warning:

[P]roducers and distributors must be prohibited from selling their milk at a lower price than that at which the entire consumer demand can be supplied at no more than a reasonable profit. Without such restriction, when one sells milk at amounts less than that at which some or many of his competitors can profitably do business, in an effort to meet the reduced prices they will be forced out of business, leaving the public with an inadequate supply of milk.<sup>30</sup>

As to the constitutionality of such provisions, California court decisions, relying initially upon the 1934 decision of the United States Supreme Court in *Nebbia v. New York*,<sup>31</sup> have sustained public regulation of the milk industry as a valid exercise of the state police power.<sup>32</sup> These decisions hold that such regulations, when not used to interfere with interstate commerce<sup>33</sup> and when not resulting in a denial of due process or equal protection, are valid when the regulations are designed to promote the public welfare and are reasonably adapted to that purpose.<sup>34</sup>

### B. Operation of the Milk Stabilization Act and Related Provisions

The basic theory behind the Milk Stabilization Act is that the Director of Food and Agriculture shall establish minimum prices for fluid milk at such levels as will insure an adequate and continuous supply of fluid milk to consumers without requiring the latter to pay more

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27. Record, vol. 11, at 1249.

28. CAL. FOOD & AGRIC. CODE §§61877, 62487.

29. CAL. FOOD & AGRIC. CODE §§62479(g), 62487.

30. Challenge Cream & Butter Ass'n v. Parker, 23 Cal. 2d 137, 141-42, 142 P.2d 737, 739 (1943).

31. 291 U.S. 502 (1934).

32. Ray v. Parker, 15 Cal. 2d 275, 101 P.2d 665 (1940); Jersey Maid Milk Products Co. v. Brock, 13 Cal. 2d 620, 91 P.2d 577 (1939). See also State Board v. Thrift-D-Lux Cleaners, 40 Cal. 2d 436, 442-43, 447, 254 P.2d 29, 32-33, 35 (1953).

33. Baldwin v. Selig, 294 U.S. 511 (1935).

34. *Nebbia v. New York*, 291 U.S. 502 (1934); Ray v. Parker, 15 Cal. 2d 275, 101 P.2d 665 (1940); Jersey Maid Milk Products Co. v. Brock, 13 Cal. 2d 620, 91 P.2d 577 (1939). See J. TOBEY, STATE CONTROL OF MILK PRICES 12-13, 22-23 (1955).

than is necessary to maintain such supply.<sup>35</sup> The focus of this comment will be upon the minimum resale prices, which include both minimum wholesale and minimum retail prices, as contrasted with the minimum prices paid by distributors to producers for raw milk.

Under the Act the Director does not establish minimum wholesale and minimum retail prices for all milk or milk products. The regulations imposed by the Milk Stabilization Act principally pertain to "fluid milk" which must meet the requirements for market milk, that is, milk suitable for human consumption in a fluid state,<sup>36</sup> as distinguished from manufacturing milk which may not be sold for such consumption in a fluid state.<sup>37</sup> In addition, the Director's authority with respect to such prices presently extends to fluid low fat milk, fluid nonfat milk, flavored milk, flavored low fat milk, and flavored nonfat milk.<sup>38</sup>

Other "milk products," together with market and manufacturing milk, are also regulated by the Dairy Products Unfair Practices Act.<sup>39</sup> This legislation prohibits specific unfair practices in the marketing of milk and milk products,<sup>40</sup> and provides for mandatory public price filing by distributors of the prices at which they are selling milk and specified milk products.<sup>41</sup> Certain manufactured milk products, while not regulated under the Milk Stabilization Act, are subject to the price-filing provisions of the Unfair Practices Act.<sup>42</sup> The Unfair Practices Act and the Milk Stabilization Act, "complementary and supplemental" enactments, are to be liberally construed together to accomplish their legislative purposes.

Minimum wholesale and minimum retail prices<sup>43</sup> are set by the Director primarily by reference to a cost standard. This means that the prices must be no more than reasonably sufficient to cover costs, as defined in the Act, for each of the several methods of distribution and to insure a reasonable return on necessary capital investment.<sup>44</sup> In establishing these resale prices, the Director takes into account the raw product cost, defined by the Act as the minimum price to be paid by distributors to producers for raw milk.<sup>45</sup> This latter price is also established by the Director.

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35. CAL. FOOD & AGRIC. CODE §§61872(b), 61877, 62479(e)(g), 62487.

36. CAL. FOOD & AGRIC. CODE §§35781-35784, 61808.

37. CAL. FOOD & AGRIC. CODE §36302.

38. CAL. FOOD & AGRIC. CODE §62472.

39. CAL. FOOD & AGRIC. CODE §61301 *et seq.*

40. CAL. FOOD & AGRIC. CODE §§61374-61375 (gifts to secure business), §61382 (price discrimination among customers), §61384 (sales below cost).

41. CAL. FOOD & AGRIC. CODE §§61411-61415.

42. CAL. FOOD & AGRIC. CODE §§61411, 62472.

43. CAL. FOOD & AGRIC. CODE §61342.

44. CAL. FOOD & AGRIC. CODE §§62479, 62487.

45. CAL. FOOD & AGRIC. CODE §62479(d).

However, to accomplish the stability purposes of the Act and upon making the required findings, the Director may, in the exercise of his discretion, establish minimum wholesale and minimum retail prices higher or lower than those sufficient to cover costs and reasonable return on capital investment.<sup>46</sup> These stability findings require a determination that such minimum prices will maintain "reasonably efficient stores and distributors" in business to insure an adequate supply of fluid milk to consumers without requiring them to pay more than is necessary to maintain such supply, and a determination that such minimum prices will not induce unfair trade practices or monopoly in the marketing of fluid milk.<sup>47</sup> This alternative pricing authority of the Director was further expanded in 1972 by legislative amendment to Section 62487.<sup>48</sup>

In contrast to minimum producer prices established under stabilization and marketing plans, minimum resale prices are established under minimum price schedules or orders.<sup>49</sup> All minimum prices, however, are established in a series of marketing areas.<sup>50</sup> Such prices may vary between marketing areas or between zones in such areas; however, it is *mandatory* that the Director establish minimum wholesale and minimum retail prices in marketing areas where he has set minimum producer prices under stabilization and marketing plans.<sup>51</sup>

Finally, the Director establishes minimum resale prices in a variety of categories. These include: sales by distributors to other distributors;<sup>52</sup> sales by distributors and subdistributors to retail stores, the typical transaction to which minimum wholesale prices apply;<sup>53</sup> sales by distributors to consumers;<sup>54</sup> and sales by retail stores to consumers.<sup>55</sup>

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46. CAL. FOOD & AGRIC. CODE §62487.

47. CAL. FOOD & AGRIC. CODE §62487(a), (b).

48. The so-called "Marler Bill," S.B. 526, CAL. STATS. 1972, c. 147, at 189, is commented upon in more detail in the text accompanying notes 76-78 *infra*. The purpose of the legislation is to afford the Director greater authority in establishing quantity discounts from minimum wholesale prices, especially at levels of larger volume purchases.

49. CAL. FOOD & AGRIC. CODE §§61818, 62486, 62487.

50. CAL. FOOD & AGRIC. CODE §§61810, 62081 *et seq.*, 62473 (zones in marketing areas).

51. CAL. FOOD & AGRIC. CODE §62472. The section was amended in 1973 for the purpose of preserving the validity of minimum producer prices where the Director fails or refuses to establish minimum resale prices or suspends or terminates such prices. CAL. STATS. 1973, c. 839. S.B. 2111, introduced on April 16, 1974, at the 1973-74 Session of the California Legislature to amend Section 62491 of the California Food and Agricultural Code may have the effect of further separating minimum producer prices from minimum wholesale and minimum retail prices.

52. CAL. FOOD & AGRIC. CODE §§61806, 61806.5, 61812, 62474, 62474.5.

53. CAL. FOOD & AGRIC. CODE §§61817, 62481 (restaurants).

54. CAL. FOOD & AGRIC. CODE §§61811, 62479(e), 62487.

55. CAL. FOOD & AGRIC. CODE §§61811, 62472, 62486.



# VERTICAL INTEGRATION: ITS IMPACT ON STORE DISTRIBUTION OF MILK AND THE RE SALE PRICING PROGRAM

At one time home delivery of fluid milk predominated in California. However, beginning as early as the 1920's, store sales of milk increasingly reflected the major channel for milk distribution,<sup>56</sup> and since that time home delivery has steadily declined. As recently as 1955 home delivery represented thirty-six percent of consumer purchases, but by 1972 had dwindled to only seven percent.<sup>57</sup>

With increasing store sales came the practice of integration of processing facility and store. The term "integration" recently came under judicial scrutiny in a Los Angeles County Superior Court proceeding, *Knudsen v. Christensen*.<sup>58</sup> Although this case and the impact it has had on the dairy industry and consumers will be discussed subsequently, it is important to note that the trial provided some of the most recent data and definitions concerning integration. During the trial, Dr. Charles E. French, then head of the Department of Agricultural Economics at Purdue University, defined integration as "the control of different decision-making units by either explicit ownership or at least joint management."<sup>59</sup> In applying this concept to the milk industry, the court, in its memorandum opinion of July 26, 1973, defined an "integrated retailer" as "an entity which owns and operates all or substantially all of the various processes through which fluid milk and sometimes milk by-products pass from the producer . . . to the ultimate consumer . . . ."<sup>60</sup>

Integration of processing distributors and retail store outlets has been dealt with to some extent since the inception of the Milk Stabilization Act. Specifically, single ownership integration, where fluid milk is sold by a distributor to stores owned by the distributor as exemplified by Safeway Stores,<sup>61</sup> was recognized through a provision exempting such an arrangement from wholesale pricing controls.<sup>62</sup> It can be concluded, in light of this provision and the fact that integration in the entire field of food distribution has increased nationally paralleling the growth and development of supermarkets,<sup>63</sup> that the trend

56. J. TINLEY, *supra* note 1, at 26-29.

57. CALIFORNIA CROP AND LIVESTOCK REPORTING SERVICE, MANUFACTURED DAIRY PRODUCTS, MILK PRODUCTION, UTILIZATION AND PRICES 51 (1972).

58. No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973).

59. Record, vol. 6, at 668.

60. *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., July 25, 1973) (memorandum opinion at 3) [hereinafter cited as Memorandum Opinion].

61. *Id.*; Record, vol. 11, at 1228.

62. CAL. FOOD & AGRIC. CODE §61812.

63. Record, vol. 6, at 668, vol. 11, at 1230 (testimony of Mr. L. A. Maes, Executive Director of Dairy Institute of California); Exhibits I-2, I-6, I-8 (introduced into evidence on June 25, 1973); Exhibit 24 (introduced into evidence on July 16, 1973).

toward integration in California is not necessarily a product of the Milk Stabilization Act.<sup>64</sup> The tied-house restrictions of California's Alcoholic Beverage Control Act,<sup>65</sup> prohibiting ownership of retailers by wholesalers and vice versa, have never been included in the Milk Stabilization Act, nor is the idea currently contemplated because such a radical change would not now be politically feasible or reasonable.<sup>66</sup>

Testimony in *Knudsen* identified four basic types of integration in the distribution of fluid milk: (1) acquisition by a retail store of its own processing plant; (2) acquisition of stores by a processor; (3) multi-store integration, or acquisition by several retail stores of a commonly owned processing plant; and (4) joint ownership of a processing facility by an established processor and retail stores, the type of integration involved in *Knudsen*.<sup>67</sup>

Cost savings become important in an industry where minimum prices are established at levels which reflect reasonably necessary costs of "sufficient, efficient distribution"<sup>68</sup> and "reasonably efficient retail stores,"<sup>69</sup> as distinguished from the single most efficient distributor or store, or integrated distributors and stores as a group. The typical integrated fluid milk operation in California *can* achieve a lower cost in distributing fluid milk through a variety of means not available to its nonintegrated or conventional counterpart. Since the state-established minimum wholesale price must reflect the cost of distribution generally, it will in most instances be higher than the costs of integrated distribution alone. This results in the integrated store having a competitive advantage since its acquisition costs are lower than the state-established minimum wholesale price and since all stores must sell fluid milk to consumers at the same minimum retail price.<sup>70</sup>

The means through which the integrated operation is able to effect costs savings include: confining deliveries to stores which are part of the integration; scheduling such deliveries for maximum efficiency; delivering in volume; restricting the actual processing operation to the most widely accepted container sizes; purchasing the remainder of required dairy products in packaged form from other distributors at sub-

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64. Record, vol. 11, at 1250.

65. CAL. BUS. & PROF. CODE §25500 *et seq.*

66. Interview with L. A. Maes, Executive Director of Dairy Institute of California, Sacramento, Calif., Dec. 4, 1973.

67. Record, vol. 11, at 1226-28, 1231-32, 1234-37.

68. CAL. FOOD & AGRIC. CODE §62479(e).

69. CAL. FOOD & AGRIC. CODE §62479(g).

70. Memorandum Opinion at 4-8. Dr. French testified that, from a cost standpoint, the nonintegrated grocer is at a competitive disadvantage with the integrated grocer whether or not fluid milk prices are publicly regulated, but that in his opinion a publicly established retail price and a publicly established wholesale price tend to encourage integration. Record, vol. 6, at 674-77.

distributor prices; and reducing or eliminating selling expense.<sup>71</sup> For the same volume and conditions of delivery, the conventional distributor can approximate the integrated distributor's fluid milk costs, but he is economically obligated to process milk for all types of wholesale customers, such as schools, hospitals, public agencies, large and small stores, and homes, and not merely those retail stores purchasing in large volume.<sup>72</sup> The cost difference between integrated operation delivery and conventional delivery has been estimated at anywhere between two and nine cents per half gallon of fluid milk.<sup>73</sup>

Recognizing the economic problems created by integration in a regulated industry (*i.e.*, the inability of smaller, yet necessary, nonintegrated operations to compete with larger integrated operations, which in turn threatens industry stability), the California Legislature, the Director, and the dairy industry have taken various steps over the years either to amend the Milk Stabilization Act or to administratively construe it in an effort to equalize competition between integrated stores and stores purchasing from conventional distributors.

The first such step was the enactment in 1955 of California Food and Agricultural Code Section 62482,<sup>74</sup> authorizing the Director, in establishing minimum wholesale prices, to provide for quantity discounts. Further, in 1961, by administrative construction of the quantity discount code provisions, the Director commenced incorporating into minimum resale price orders provisions for an additional quantity discount for limited or express service.<sup>75</sup> Under this concept some of the delivery functions normally performed by the distributor are transferred to the retail store so that in effect the distributor accomplishes dock delivery of fluid milk to the store platform, and the store then becomes responsible for all in-store handling functions.

Finally, in 1972 the California Legislature enacted the Marler Bill, amending California Food and Agricultural Code Section 62487 to permit the Director, in the exercise of his alternative price fixing authority, to establish "particular quantity discounts" at a level higher or lower than costs and return on investment of distributors *as an average group*.<sup>76</sup> The enactment is intended to permit a conventional distributor to serve large volume purchasers at a quantity discount under circumstances where such service is not below the costs of the

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71. Record, vol. 1, at 58-59, vol. 11, at 1245-47, 1299, 1307-10, vol. 12, at 1404-05.

72. Record, vol. 11, at 1247.

73. Record, vol. 1, at 59.

74. A.B. 2335, CAL. STATS. 1955, c. 1310, at 2378.

75. Record, vol. 11, at 1261-63.

76. CAL. FOOD & AGRIC. CODE §62487; see note 48 *supra*.

particular distributor, although it might be below the costs of other distributors not situated for service in such large volumes.<sup>77</sup> This would enable "distributors in the dairy industry to compete effectively for the business of large volume buyers who would otherwise tend to establish their own private processing plant."<sup>78</sup>

The described legislative enactments and administrative actions of the Director did not halt single-store integration<sup>79</sup> where the store became large enough to support such an operation; however, until the Knudsen joint venture concept was introduced, multi-store integration had slowed to the point that the most recent such organization occurred in 1957.<sup>80</sup> The legislation was also successful in stabilizing integration without "disruption to the fifty percent of the industry not involved in supermarket sales,"<sup>81</sup> thus preserving the economic purposes of the Milk Stabilization Act as well as safeguarding the public interest by maintaining an adequate supply of milk at fair and reasonable prices to the entire public.

#### THE EFFECT OF THE JOINT VENTURE CONCEPT ON THE MILK STABILIZATION ACT

Joint venture first emerged in 1967 when Knudsen, a prominent conventional distributor in the Los Angeles area, under urging on the part of its larger volume retail store customers,<sup>82</sup> established a second processing plant in the name of a subsidiary, Todds Food Company. Knudsen offered a select group of its wholesale customers the opportunity to purchase stock in Todds, which then became jointly owned by Knudsen and these preferred wholesale customers. Profits realized by the joint venture were paid to the shareholders through ownership dividends which were proportionate to the amount of milk and dairy products purchased.<sup>83</sup> Such dividend payments have the effect of reducing the price paid for fluid milk by stores participating in the joint venture below the state-established minimums.<sup>84</sup> However, the initial processor's wholesale customers whose volume is not sufficient to meet

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77. Record, vol. 11, at 1263-64, 1285, vol. 12, at 1228.

78. Letter from Senator Fred W. Marler, Jr. to C. B. Christensen, Director of the California Department of Food and Agriculture, June 9, 1972, reprinted in, Dairy Institute of California, Legislative Bulletin, No. 6, June 15, 1972.

79. Record, vol. 1, at 17, 23, 26, vol. 12, at 1228.

80. Record, vol. 12, at 1235-36; see also Exhibit 29 (introduced into evidence on July 17, 1973).

81. Testimony of L. A. Maes, *August Minimum Resale Price Hearings* at 73.

82. Record, vol. 7, at 766-67.

83. The characteristics of the Knudsen-Todds joint venture are succinctly summarized in the presentation prepared by Mr. Jed A. Adams before the Senate and Assembly Agriculture Committees at their interim hearing in San Diego. *California Milk Marketing Presentation* at 2.

84. *Id.*

the requirements for participation in the joint venture must continue to purchase from the initial processor at established minimum wholesale prices without the benefit of later reduction through dividend payments.<sup>85</sup>

After considerable study of the joint venture, the office of the Director in late 1968 issued a letter approving the Knudsen-Todds arrangement.<sup>86</sup> However, as the joint venture developed in the manner outlined above, the Director soon thereafter issued a "cease and desist" letter to Knudsen asserting that Todds, in contravention of the Director's policy and that of the Act, was unlawfully returning dividends to its store owners in proportion to their purchases from Todds.<sup>87</sup> In the fall of 1969 the Dairy Institute of California, a non-profit trade association of milk distributors, filed a verified complaint with the Director<sup>88</sup> seeking an administrative determination of the legality of the joint venture.<sup>89</sup> Following a lengthy hearing on the complaint, the administrative hearing officer issued his decision finding the joint venture illegal:

Todds constitutes a device or mechanism by which Knudsen as a processor-distributor continues to do business with a selected group of retailers and offers to those retailers the opportunity to purchase fluid milk and other dairy products at a price less than the established or posted prices for items sold.<sup>90</sup>

The Director adopted this decision on May 23, 1970.<sup>91</sup> Knudsen then instituted litigation seeking a declaration that the joint venture plan violated no provision of the Milk Stabilization Act. By cross-complaint the Director sought both an injunction and civil penalties claiming that the Knudsen-Todds operation violated the Act.<sup>92</sup> An initial trial of the action in 1971 resulted in a judgment in favor of the Director. However, the court of appeals, in an unpublished opinion, reversed the trial court judgment principally on the ground that the judgment had been reached without a full trial on the merits.<sup>93</sup> The trial court had held that because Knudsen struck from its complaint allegations seeking a review of the administrative decision, such

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85. Record, vol. 3, at 336, vol. 4, at 477, vol. 5, at 571.

86. Exhibit L-7 (introduced into evidence on June 26, 1973).

87. Exhibit L-8 (introduced into evidence on June 26, 1973).

88. Exhibit 3 (introduced into evidence on June 26, 1973) (Director's first amended cross-complaint filed under the provisions of CAL. FOOD & AGRIC. CODE § 61471 *et seq.*).

89. Record, vol. 11, at 1267.

90. *In re Complaint Against Todds Food Company*, No. OLA 22,161 (Mar. 10, 1970).

91. Exhibit 14 (introduced into evidence on July 6, 1973).

92. No. 980 923 (Sup. Ct., L.A. Co., July 10, 1970).

93. *Knudsen v. Fielder*, 2d Civ. 39779 (Cal. App. 2d dist., Nov. 30, 1972).

decision had become final leaving no question before the court except enforcement.<sup>94</sup>

The case was then returned for a full trial before Judge Charles A. Loring of the Los Angeles County Superior Court. On July 26, 1973, Judge Loring issued his memorandum opinion directing judgment to be entered in favor of Knudsen.<sup>95</sup> Due to a stipulation between Knudsen and the Director, no appeal was taken from the trial court judgment and the form of judgment as stipulated had no supporting findings of fact or conclusions of law.<sup>96</sup> Thus many important questions of law raised in the proceeding were not given appellate court review. These questions included the determination of: (1) whether unlawful price discrimination exists between purchasers who buy from Knudsen but who pay the state-established minimum wholesale price without later reduction, and purchasers of Knudsen-labeled products from Todds whose minimum wholesale price payments are subject to later reduction through stock dividends; (2) whether assistance by Knudsen to Todds was for the purpose of acquiring or restoring the fluid milk business of the Knudsen wholesale customers who became shareholders of Todds and purchasers of Knudsen-labeled products through Todds; (3) whether the Director has the authority to prohibit, in multi-store integration, payment of dividends by the processing entity to the store owners in proportion to purchases of fluid milk and other dairy products by such store owners from the processing entity; and (4) whether any restraint of trade exists in the form of agreements between Knudsen, Todds, and store owners of Todds that such stores will purchase Knudsen-labeled products to the total or partial exclusion of competing dairy products.

The judge commented that no "mere price regulation [could] completely eliminate the inequality which is necessarily inherent between [integrated and nonintegrated operations]," and that the Knudsen-Todds concept was a permissible means by which formerly conventional distributors could deal with the problem and meet competition.<sup>97</sup> In addition, one of the most sweeping conclusions of the memorandum opinion concerned the issue of pricing between a processor owned by several stores and the store owners. Prior to the trial court decision, the Director had taken the position that in multi-store integrated

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94. *Id.* at 6-8, 11.

95. Memorandum Opinion.

96. The judgment entered in the action was filed on September 25, 1973, in Los Angeles County Judgments Book 6860, at 301. It is briefly and narrowly stated and, in substance, adjudges that the Knudsen-Todds arrangement "is lawfully organized and structured and is lawfully operating as a licensed fluid milk distributor," and that Todds may distribute its profits to its members and adjust ownership among its members based upon a measure of purchases described as "Modified Delivery Units."

97. Memorandum Opinion at 16, 20.

arrangements, regardless of later dividends, initial purchases of fluid milk by the retail stores from the processor-distributor in which they had an ownership interest must be made at state-established minimum wholesale prices.<sup>98</sup> Todds in fact charged such prices to its members.<sup>99</sup> The Director had also taken the position that dividends could not be returned by such a distributor to its store owners in proportion to their purchases of fluid milk.<sup>100</sup> It was Knudsen's contention at the trial that Jerseymaid and Golden Creme, two multi-store integrated operations, had returned dividends in proportion to purchases but that the Director had not instituted enforcement proceedings to halt the practice.<sup>101</sup> The Director replied that such enforcement proceedings awaited the outcome of the *Knudsen* litigation.<sup>102</sup>

The memorandum opinion appears to remove the authority of the Director on both points stated above, so that (1) a multi-store owned distributor may return dividends to its store owners based upon their volume of purchases of fluid milk from the distributor, and (2) in respect to transactions between them, the multi-store owned distributor and its store owners are removed from *any* minimum wholesale pricing controls under the Milk Stabilization Act in the same manner as are single-entity integrated retailers.<sup>103</sup> Although the dairy industry concern over such reasoning parallels the concern of the Director,<sup>104</sup> in view of the stipulation of the Director that judgment could be entered in the *Knudsen* action without supporting findings, the question arises whether and to what extent the memorandum opinion is now superseded by the judgment on such matters as the application of the minimum wholesale price to initial sales between a multi-store owned processor and the store owners.

Under the Act, the Director is the public agent authorized by the legislature to determine reasonable profits for distributors and retail stores since it is his duty to establish minimum prices to cover costs and reasonable return on capital investment.<sup>105</sup> In the joint venture

98. Record, vol. 8, at 894-95, vol. 12, at 1444-45, 1482.

99. Record, vol. 4, at 466-68, 477.

100. Exhibit L-1 (introduced into evidence on June 26, 1973); Record, vol. 7, at 851, vol. 10, at 1196-97, vol. 12, at 1456.

101. Brief for Plaintiff at 37, *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973).

102. Brief for Dairy Institute of California as Amicus Curiae at 34, *Knudsen v. Christensen*, No. 980 923 (Sup. Ct., L.A. Co., Sept. 25, 1973).

103. Memorandum Opinion at 15-19. The reasoning behind the exemption of single-entity integration from wholesale price controls as set forth in Section 61812 of the California Food and Agricultural Code is based on the premise that when an integrated operator, such as Safeway, transfers fluid milk from its processing plant to its stores, there is no "sale" since the operator is dealing with himself. Record, vol. 8, at 894-95. However, where more than one store owns a processor, there are two different entities involved so that there would appear to be a "sale" between the two entities which the Director can regulate. Record, vol. 12, at 1482, 1487-88.

104. *August Minimum Resale Price Hearings* at 79.

105. CAL. FOOD & AGRIC. CODE §62487.

concept, as it is organized and implemented by Knudsen and a select group of its wholesale customers, Knudsen and such customers determine between themselves the division of profits from distribution of Knudsen-labeled fluid milk and other dairy products. Upon organization of the joint venture these customers, originally paying Knudsen state-established minimum wholesale prices for fluid milk, simply ceased all such purchases directly from Knudsen and transferred their purchases of Knudsen-labeled products to the jointly owned distributor, Todds, with the result that the minimum wholesale price which they paid Todds for such products became subject to later reduction through stock dividends.<sup>106</sup>

Under these circumstances the questions may fairly be asked where the line is to be drawn in the matter of joint arrangements between distributors and their store customers for division of profits, and whether the Milk Stabilization Act can survive such private industry determinations of profit division between distributors and retail stores.

As a result of the judgment in *Knudsen*, devoid of findings of fact and removed by stipulation from appellate court review, it appears that the future of the minimum resale pricing controls under the Milk Stabilization Act has been left in a state of considerable doubt. In response to this situation, the Director of Food and Agriculture first summarized the impact of the trial court judgment on the administration of the Act as follows:

Joint ventures . . . result in expansion of the total market serviced by integrated firms and increase the amount of fluid milk that is not subject to the minimum wholesale prices established under the legislative standards of the Act. Under our tentative interpretation of the court judgment . . . a retail store must become a member of a joint venture to obtain this lower price and the joint venture must have a processing plant different from the distributor's regular plant to qualify . . . . If the savings from large deliveries are to be passed on to the consumer through a lower minimum retail price, the smaller stores will have to charge more than the minimum out-of-store price to retain their margin. The opportunity to purchase below the established minimum wholesale price provides a tremendous incentive for large grocery stores to join joint venture operations. The regulated wholesale price acts as the umbrella and the higher the established wholesale price relative to raw product cost, the greater the incentive.<sup>107</sup>

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106. Record, vol. 3, at 336, 342, vol. 4, at 477, vol. 5, at 571, vol. 7, at 766.

107. *California Milk Marketing Presentation* at 3; see also Record, vol. 11, at 1260.



Without, as yet, any legislative curbs on joint ventures and with the increased incentive to join such operations, the competitive ability of the conventional distributor, serving all facets of the public with a full line of milk products, may well be in jeopardy. This, in turn, places a greater strain on the public availability of an adequate supply of milk in all places at fair and reasonable prices.

## THE FUTURE OF THE RESALE PRICING PORTIONS OF THE MILK STABILIZATION ACT

### A. *Initial Response to and Suggestions Resulting from the Decision in Knudsen v. Christensen*

After the issuance of the memorandum opinion in *Knudsen v. Christensen*, attention of the dairy industry and consumers focused on three areas: whether interested parties desired retention of the Milk Stabilization Act; whether action might be taken within the framework of present law; and whether legislative changes were needed to cope with the problems which the joint venture has created.

#### 1. *Retention of the Act*

In order to examine the question concerning retention of the Act in general, the Director of Food and Agriculture shortly after the decision in *Knudsen* held a three-day public hearing in Sacramento.<sup>108</sup> Due to the responses drawn from well represented consumer groups,<sup>109</sup> members of the dairy industry, and retail store groups, the California Department of Food and Agriculture subsequently declared that "[a]s a result of this hearing the Director concluded the program does serve the public interest and announced the department's policy to maintain the Milk Stabilization program."<sup>110</sup>

#### 2. *Action Under Present Law*

As the Milk Stabilization Act authorizes the Director, after public hearing, to suspend on a temporary basis all or particular minimum wholesale and minimum retail prices in a marketing area or zone within such area,<sup>111</sup> the Director, in response to an industry petition,

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108. *August Minimum Resale Price Hearings*.

109. Consumer groups represented at the hearing included the Consumers Cooperative of Berkeley, California Food Action Campaign, San Francisco Consumer Action, and Consumer Federation of California.

110. *California Milk Marketing Presentation* at 4.

111. CAL. FOOD & AGRIC. CODE §62491. No doubt as a result of the problems outlined in this comment, S.B. 2111 was introduced at the 1973-74 Session of the California Legislature on April 16, 1974, for the purpose of amending Section 62491 to extend the Director's authority under that section, presently encompassing the suspension of resale prices only, to include *termination* of such prices as well.

scheduled a public hearing in one of the largest marketing areas in the state—the North Central Valley Marketing Area which includes Sacramento County. Following the hearing and under the authority granted to him by the Act, the Director ordered: “Minimum subdistributor and minimum wholesale prices for fluid milk and fluid low fat milk sold in one gallon, half gallon, and quart containers . . . shall be suspended until further notice.”<sup>112</sup> Research discloses no prior utilization by the Director of his authority to suspend minimum prices, although the supporting statute has been in effect since 1961.<sup>113</sup> In the Sacramento area, the wholesale price suspension temporarily stabilized the market. As required by the Act, the extension of minimum wholesale price suspension was considered at a public hearing on February 5, 1974.<sup>114</sup>

It should be noted, of course, that the potential freedom of a minimum wholesale price suspension is limited because (1) the minimum out-of-store price must still be maintained, (2) the requirement of price-filing remains, and (3) the prices filed should be reasonable if distributors desire restoration of state-established prices. As a result, in the Sacramento area, where there has been a suspension of minimum wholesale prices, most distributors have followed the price leader in the area in filing their minimum wholesale prices.<sup>115</sup>

Simultaneously with the consideration of temporary suspension of selected minimum wholesale prices, the Director also conducted a series of public hearings in various marketing areas<sup>116</sup> for the purpose of giving consideration to the deepening of wholesale discounts pursuant to Section 62487 of the California Food and Agricultural Code, as amended by the Marler Bill.<sup>117</sup>

### *3. Possible Amendment of the Act*

Along with these two approaches to the integration problem under present law which emerged immediately from the *Knudsen* litigation and from the public hearings before the Director, there was also considera-

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112. North Central Valley Order No. 45, Nov. 9, 1973.

113. CAL. FOOD & AGRIC. CODE §62491, as enacted, CAL. STATS. 1961, c. 2195, at 4540.

114. Cal. Dep't of Food and Agriculture, Notice of Public Hearing, issued Sacramento, Calif., Jan. 18, 1974.

115. Interview with Jed A. Adams, Milk Marketing Administrator for the California Department of Food and Agriculture, Sacramento, Calif., Dec. 7, 1973.

116. See Cal. Dep't of Food and Agriculture, Notice of Public Hearing, issued Sacramento, Calif., Nov. 15, 1973, in which three separate hearings for the Central Valley, Tulare-Kings, and Kern County Marketing Areas were noticed.

117. See text accompanying notes 76-78 *supra*.

tion given to legislative amendment of the Milk Stabilization Act to make it more responsive to the current permissible trends in the marketing of fluid milk. In the Director's presentation to the Senate and Assembly Agriculture Committees in San Diego on November 8, 1973, four such amendments were suggested.<sup>118</sup> Two of the suggested amendments appear to be nonsubstantive. The first is amendment of Section 62482 of the California Food and Agricultural Code to permit service charges applicable to minimum wholesale prices. According to the Director's statement, this amendment would permit the Director to "establish the minimum wholesale price in the large volume deliveries with increases to cover the additional costs of servicing progressively smaller volume deliveries."<sup>119</sup> The second suggestion is for the addition of a new provision to the Code to provide discounts for prompt payments. Present regulations permit a distributor to extend credit to a wholesale customer for sixty days.<sup>120</sup>

The remaining two legislative suggestions are substantive and go to the basic price-fixing standards of the Act. The first of these is amendment of the Act to enable the Director to establish minimum wholesale prices based upon the costs of only the most efficient distributors rather than the costs of "sufficient, efficient distribution" as at present.<sup>121</sup> A serious constitutional question would seem to be present if the price-fixing standard were to result in the establishment of minimum prices which cover the costs of only the most efficient operator in the market, or the so-called "true minimum," notwithstanding the inability of the single operator to supply all the needs of the market. Dr. French testified that if minimum prices were set at only the level of the most efficient operator, he did not "believe that [that] would result in effecting the intent of most of the control programs that [he knew] of because that [would] not bring forth an adequate supply."<sup>122</sup>

The second substantive suggestion concerns amendment of Section 62479(g) of the California Food and Agricultural Code to permit the Director to establish out-of-store minimum retail prices based upon the costs of only the most efficient retail stores, again the true minimum, rather than the costs of "all reasonably efficient retail stores" as at present.<sup>123</sup> Such an amendment would appear to favor the large vol-

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118. *California Milk Marketing Presentation* at 6.

119. *Id.*

120. CAL. ADMIN. CODE tit. 3, §1883.

121. For the present statutory standard of "sufficient, efficient distribution" see CAL. FOOD & AGRIC. CODE §62479(e).

122. Record, vol. 6, at 715.

123. CAL. FOOD & AGRIC. CODE §§62479(g), 62487.

ume stores, again potentially endangering the adequacy of supply to consumers.

There has been criticism of these suggestions which were made at a time when there was little certainty as to what effect the legality of the joint venture would have on the dairy industry and on the Director's ability to effectively establish minimum resale prices. Due to current activity in the industry, it is now questionable whether such suggestions are still being considered as viable legislative alternatives to the present programs as set forth in the Milk Stabilization Act.

### *B. Recent Responses and Problems—The Future of the Act*

Since the holding in *Knudsen v. Christensen*, it has become increasingly apparent that the future of the Act will be affected by more than the specific joint venture as presented in *Knudsen*. Although the joint venture increases profits to its grocer participants, it also appears wasteful and uneconomical in that a processor separates his processing facilities into two plants, one geared for the benefit of joint venture participants, the other left to diminishing efficiency because of the removal of the joint venture volume from the processing plant.<sup>124</sup>

#### *1. Alternative Arrangements*

The continued effectiveness of the Act will depend upon the Director's ability to enforce minimum wholesale prices in a market where various types of integration arrangements are under study for purposes of *competing with* the joint venture. Many arrangements may be conceived of to compete with the joint venture if the industry generally engages in programs for integrating conventional distributors and their store customers. For example, a conventional distributor might lease his processing plant to a group of retail store customers under a lease arrangement which could be canceled without great financial penalty to the grocers if they so elected. Under the lease the store group could process fluid milk utilizing, for a fee, the processing expertise and the label of the conventional distributor. Once licensed as a distributor, the store group could then, under the reasoning of the memorandum opinion in *Knudsen*, make processed fluid milk available, free from minimum wholesale price controls, to the members of the group, whether as stockholders in a corporation or partners in a partnership. Even if such controls were applicable, their effect would be diluted by dividend returns on purchases by the members of the group from

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124. *California Milk Marketing Presentation* at 3; Record, vol. 11, at 1319, vol. 12, at 1258-60, 1320, 1359, 1371-72, 1380.

the licensed processing entity which such members had organized. The store group could also admit the conventional distributor to ownership in the lessee processing entity, so that the latter would be in a position to supply both the stores and the conventional distributor with fluid milk. In this situation there would be, as to fluid milk, a joint venture confined to one processing plant.

Also to be considered is the possibility that cooperative associations of grocers organized under the provisions of the California Corporations Code<sup>125</sup> might become processing distributors. Section 12805 prescribes patronage dividends to cooperative members "based in amount upon the volume of business transacted with the corporation by such patrons." Previously, the Director of Food and Agriculture was able to prevent store owners from receiving dividends proportionate to the volume of fluid milk they purchased from the processing organization. As this policy was in direct conflict with the provisions of the California Corporations Code relating to cooperative corporations, grocer cooperatives have not become fluid milk processors. Under the reasoning of *Knudsen*, however, the Director may no longer proscribe such dividend returns.<sup>126</sup> Grocer cooperatives may now think more seriously about forming their own processing plants. If they do, the question arises whether all grocer members of the cooperative will have effectively removed themselves from the controls established by the Director in the form of minimum wholesale prices applicable to retail stores generally.

The potential of these new competitive forms of integration presents the Director with the problem of determining whether there may be a joint venture without two separate processing plants. However he handles this situation, his enforcement powers will be suspect because of the result in *Knudsen*. The scope of his authority is even more questionable because of his decision not to seek appellate review of the troublesome legal issues presented in *Knudsen* and because there have been no appellate decisions dealing with these issues. Can the Director reasonably expect that *any* integration designed to compete with the joint venture will be invalidated by a trial court in light of the reasoning expressed in the memorandum opinion of Judge Loring?

## 2. Usage of Director's Licensing Power

Still another source of conflict is the Director's power to issue licenses to distributors. Any new integration of distributors and stores will

125. CAL. CORP. CODE §12200 *et seq.*

126. See text accompanying note 103 *supra*.

require a distributor's license for the newly integrated entity. The Director has the authority to deny such a license if he is not satisfied with the "character, responsibility and good faith" of the applicant.<sup>127</sup> As competition for grocer trade through integration intensifies, it is likely that grocers will be offered participation without much financial risk on their part. Where will the Director draw the line in approving such arrangements? And what chance of success can he expect in the courts if he denies such a license application, and the applicant seeks judicial review?<sup>128</sup>

### *3. Permissive Establishment of Minimum Prices*

As the impact of joint venture and competing integration arrangements on the Milk Stabilization Act has become more severe, proposals for legislative amendments of the Act *now* include terminating its provisions as to minimum wholesale pricing or making enforcement of such provisions permissive rather than mandatory. The latter suggestion would afford the Director authority to remove minimum wholesale pricing in a marketing area for an indefinite period as contrasted with his present price suspension authority which can be exercised only on a temporary basis. This would inhibit stores and distributors from waiting until a temporary suspension is lifted to institute their new organizations or combinations.

### *4. Minimum Retail Price*

Joint ventures and other similar arrangements where the store customers of a processing distributor secure a larger profit margin than they could by purchasing at state-established minimum wholesale prices obviously place a great deal of pressure on the retail price, maintenance of which is a key feature in integration.<sup>129</sup> The public hearing held on February 5, 1974, reflected this strain. One purpose of the hearing was to determine whether minimum retail prices of gallon, half gallon, and quart containers of fluid milk and fluid low fat milk should be "suspended or reduced in the event that the Director finds that suspension of minimum wholesale prices [should] be continued."<sup>130</sup> The notice of the meeting stated that "[m]arketing activities and conditions at the wholesale level indicate that minimum retail price levels

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127. CAL. FOOD & AGRIC. CODE §61975.

128. See CAL. GOV'T CODE §11523; CAL. CODE CIV. PROC. §1094.5.

129. See text accompanying notes 70-73 *supra* (greater store margins being derived from savings on the wholesale level and sale at the state-established minimum retail price).

130. Cal. Dep't of Food and Agriculture, Notice of Public Hearing, issued Sacramento, Calif., Jan. 18, 1974.

may result in unwarranted margins at some levels of purchase."<sup>131</sup> Of all actions instituted by the Director and the industry since the *Knudsen* trial, the discussion and the potential of suspending minimum retail prices may well be the most significant. As noted, the minimum retail price is a key feature in integration, for it is through the maintenance of such prices that single ownership integration can realize greater profits through its exemption from minimum wholesale prices and increased plant efficiencies over those realized by a conventional distributor. The minimum retail price also furthers the profit-sharing features of joint venture. However, it should be noted that a minimum retail price is considered a key *stability* factor,<sup>132</sup> and the success or failure of the market in maintaining stability during any suspension of the minimum retail price may finally determine whether the Act *has* outlived its usefulness. Alternatively, the Director may well decide that where such minimum retail prices are *not* suspended along with the minimum wholesale price, the public interest will not be served in a substantially integrated market unless the increased store margins resulting from integration are reflected in a *reduction* of state-established minimum retail prices.

### 5. *Repeal of Minimum Resale Pricing*

Past legislative proposals indicate that the Milk Stabilization Act, in all of its phases, is vulnerable to total or partial repeal.<sup>133</sup> Even after the joint venture concept was first approved in *Knudsen*, most distributors, as evidenced by early hearings, continued to support the Act despite the threat of economic instability.<sup>134</sup> The hearings further indicated that consumers were of the opinion that although price regulations were not completely desirable, the price and the supply of milk that the regulations helped to maintain were definitely in the public interest.<sup>135</sup> As an alternative to total repeal of the resale pricing provisions of the Act, consideration could be given to legislation preserving, in the Director, authority to establish from time to time, on a temporary basis only, minimum wholesale prices and/or minimum retail

131. *Id.*

132. Interview with L. A. Maes, Executive Director of Dairy Institute of California, Sacramento, Calif., Dec. 4, 1973.

133. *E.g.*, A.B. 2417, 1973-74 Regular Session (to repeal the consumer pricing provisions of the Act); A.B. 1831, 1970 Regular Session (to repeal the minimum wholesale pricing provisions of the Act); A.B. 1848, 1969 Regular Session (to repeal the minimum wholesale pricing provisions of the Act); S.B. 705, 1969 Regular Session (to make all resale pricing permissive); S.B. 1010, 1968 Regular Session (to exempt certain subdistributor pricing from control); A.B. 2256, 1967 Regular Session (to repeal the resale pricing provisions); A.B. 1918, 1967 Regular Session (to repeal the resale pricing provisions); S.B. 971, 1967 Regular Session (to make all resale pricing permissive rather than mandatory).

134. See text accompanying notes 109-110 *supra*.

135. *August Minimum Resale Price Hearings* at 153.

prices in a marketing area threatened by severe market instability. However, in light of the potential for new joint ventures and competing arrangements, and the present consideration by the Director of suspension or reduction of the minimum retail price, repeal of either or both of the minimum wholesale and minimum retail pricing provisions of the Milk Stabilization Act may become increasingly likely.

### CONCLUSION

The importance of milk as a dietary requirement and the production of milk to meet consumer demand have by no means diminished since the 1930's when the need for regulation of the milk industry to insure an adequate supply of quality milk to the public at reasonable prices first became acute. In the food products industry, by far the largest major industry in the United States in dollar value of end products distributed,<sup>136</sup> dairy products rank second to meat and represent the seventh largest single industry nationally.<sup>137</sup> Among the states, California is the second largest distributor of dairy products and the largest seller of fluid milk.<sup>138</sup>

In light of these statistics illustrating that the dairy industry is not only large but also powerful, it would appear that the need for regulation has not diminished. Although circumstances have changed since the 1930's, the reasons behind the enactment of price regulations of fluid milk have, if anything, increased.

It must also be noted that California's Milk Stabilization Act has served the consuming public well, as California's pricing regulations are among the most sophisticated in the country and have insured that consumers within the state pay one of the lowest prices for fluid milk in the nation.<sup>139</sup> In the past, the California Legislature and the Director and his staff have amended the regulatory program and have changed administrative practices under the program so that the Act has accomplished useful purposes.<sup>140</sup>

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136. 2 U.S. DEP'T OF COMMERCE, CENSUS OF MANUFACTURES 28 (1967), *supplemented by*, U.S. DEP'T OF COMMERCE, ANNUAL SURVEY OF MANUFACTURES FOR 1971 at 3.

137. 2 U.S. DEP'T OF COMMERCE, CENSUS OF MANUFACTURES, code 20, at 3-5 (1967); U.S. DEP'T OF COMMERCE, 1972 CENSUS OF MANUFACTURES (ADVANCE REPORT).

138. 2 U.S. DEP'T OF COMMERCE, CENSUS OF MANUFACTURES, code 20, at 5, code 20B, at 9 (1967).

139. For a summary of past departmental studies of this point see, Testimony of L. A. Maes, *August Minimum Resale Price Hearings* at 68-79; see also Statement of L. A. Maes, *Hearings on California Milk Marketing Program Before the California Senate and Assembly Interim Committees on Agriculture*, Nov. 8, 1973, San Diego, Calif.

140. Indicative of these efforts to make the Milk Stabilization Act as responsive as possible to current trends, Senate Resolution 98 was introduced on April 15, 1974, at the 1973-74 Session of the California Legislature. On adoption of this resolution,



However, the conclusion is inescapable that the present economics of the industry, accentuated by integration and legal construction of the joint venture, confront the resale pricing provisions of the Act with their greatest challenge for survival to date. Since its inception, the Act has been premised upon the establishment of minimum prices which are cost related. Ultimately, it would seem that no system of minimum prices devised by the Director could be justified from a public benefit standpoint unless it was founded upon costs. As noted in the introduction of this comment, the problem confronting the Director, in the interests of stability and maintenance of an adequate public milk supply, is to arrive at a system of minimum prices which will be adequate for representative distributors and retail stores notwithstanding what seem to be increasingly wide variations between the costs of individual distributors and stores.

In evaluating the possibility of total repeal of the resale pricing provisions of the Milk Stabilization Act, it is hoped that restructure, rather than repeal, will be considered by the legislature and that in any event a strong unfair practices act will be retained. Although it would seem that arrangements such as joint venture would starve, rather than thrive, without the Milk Stabilization Act and that unfair competitive practices would continue to be controlled by the present Unfair Practices Act, repeal of the resale pricing provisions of the Milk Stabilization Act would end the security of supply, price, and quality of fluid milk that public regulation has achieved for consumers as well as members of the dairy industry for thirty-seven years.

*Sara C. Steck*

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the Senate will undertake an in-depth review of the fluid milk stabilization and marketing provisions as a result of the joint venture's emergence as a "viable entity" and substantial changes in business practices which have led to "unforeseen relationships between processing distributors and retail outlets."